

No. 16063 ✓

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MONOLITH PORTLAND CEMENT COMPANY, a Corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee,

UNITED STATES OF AMERICA,

Appellant,

vs.

MONOLITH PORTLAND CEMENT COMPANY, a Corporation,
Appellee.

On Appeals From the Judgment of the United States District
Court for the Southern District of California.

BRIEF FOR THE UNITED STATES.

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BRIEF FOR THE UNITED STATES.

Opinion Below.

The findings of fact, conclusions of law and judgment of the District Court [R. 62-73] are not yet officially reported.

Jurisdiction.

These appeals involve federal income taxes for the year 1951. The taxes in dispute were paid as follows: \$126,000 on March 17, 1952; \$126,000 on June 13, 1952;

\$75,262.55 on September 16, 1952; \$57,531.59 on December 15, 1952; and, \$4,282.70 on February 15, 1954. [R. 69.] Claim for refund was filed on March 9, 1955, and was neither allowed nor disallowed during the following six months. [R. 68.] On July 27, 1956, within the time provided in Section 6532 of the Internal Revenue Code of 1954, the taxpayer brought an action in the District Court for the recovery of a portion of the taxes paid. [R. 68.] Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346. The judgment was entered on April 14, 1958. [R. 72-73.] Within sixty days, on May 16, 1958, notice of appeal was filed by the taxpayer. [R. 73-74.] Also within sixty days, on June 10, 1958, notice of appeal was filed by the United States. [R. 75.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Questions Presented.

The taxpayer mined a calcium carbonate rock which it blended with other materials (some mined and some purchased) in an integrated mining-manufacturing process resulting in the production of Portland cement. The District Court found that under the provisions of Section 114(b)(4)(A) of the Internal Revenue Code of 1939 the taxpayer was entitled to compute its percentage depletion deduction at the 10 per cent rate provided for "calcium carbonates." It was further held that the taxpayer's commercially marketable mineral product was bulk Portland cement and that the income attributable to the mined and purchased ingredients should not be excluded from the depletion base, but that the cost of bags and bagging should be excluded. Both parties have appealed.

1. The question presented by the taxpayer's appeal is whether the District Court erred in classifying its mineral

as calcium carbonate (10 per cent) rather than chemical grade limestone (15 per cent).

2. The question presented by the Government's cross-appeal is whether the income attributable to the mined and purchased ingredients was erroneously included in the depletion base.

Statutes and Regulations Involved.

The pertinent provisions of the Internal Revenue Code of 1939 and Treasury Regulations 111 are set forth in the Appendix, *infra*.

Statement.

The relevant facts as stipulated by the parties [R. 16-17; 27-40; 40-42], found by the District Court [R. 62-72], and appearing in evidence of record are summarized below.

The taxpayer, Monolith Portland Cement Company, is a Nevada corporation conducting business in the State of California. During the year 1951 it had a limestone quarry and cement plant at Monolith, California, and mined limestone which it used in making cement. It also mined other raw materials which it used in making cement—clay #1, clay #2, tufa, and gypsum—at places some distance away. In addition, it purchased, for use in its operations, stipulated quantities of iron cinders and fluorspar. Applying customary processes used in the cement industry, these raw materials were blended and processed into Portland cement at the cement plant at Monolith, California. [R. 18-19, 63.]

The processes employed by the taxpayer in arriving at the finished product of Portland cement can be summarized as follows: The calcium carbonate rock was blasted from

the face of the quarry by the open pit method, and further broken into manageable size by secondary or squib blasting. The rock was then taken by rail to a large primary crusher which reduced the size of the rock to pieces with a maximum diameter of about six inches. After secondary crushing the rock was transported to the cement plant and placed either in the limestone hopper or in a raw pile used to replenish the hopper. The limestone was then blended with clay #1 from another hopper, with clay #2¹ from another hopper, and with iron cinders from another hopper by measuring and conveying equipment. The blended materials were then gravity fed into a ball mill where water equal to approximately 36 per cent of the weight of the dry raw materials was added and it was ground to a proper fineness known as a "slurry." The slurry after further grinding in tube mills was conveyed to a wet slurry tank where it was kept in suspension and blended by a revolving paddle mechanism and, after blending, fed into a kiln. The kiln fed slurry was run into the upper end of rotary kilns, which were in the form of long rotating cylinders set at a slight inclination. The feed traveled gradually toward the lower end. Hot gases from a flame at the lower end evaporated the water from the slurry, and the application of heat at a proper temperature chemically combined the remaining material to a dense "clinker." The clinker was conveyed to a grinding mill where gypsum was added, and these were ground to a great fineness to become one of the various types of Portland cement. It does not appear in the stipulation the precise point at which the tufa and fluorspar were added. [R. 18, 21-24.]

¹Clay #2 was called silica in production records [R. 19] and on the income tax return [Ex. No. 2, R. 43].

At the completion of the processes referred to above, the cement was stored in silos. From there it was either loaded and shipped in bulk or bagged and loaded and shipped in bags. During the year 1951, 63.49 per cent of the taxpayers's cement sales were of bulk cement. The remaining sales were of cement placed in bag or sack containers. The only product sold by the taxpayer during the year 1951 as a result of its limestone mining operations was Portland cement. [R. 64-65.]

The taxpayer timely filed a corporation income tax return for the year 1951 on which it claimed depletion deductions for calcium carbonate, clay and tufa. The depletion base for the 10 per cent allowance for calcium carbonate was computed in the return by treating the slurry as the first marketable mineral product and reducing the gross income from mining by income attributable to subsequent steps. A claim of refund on the theory that the finished product, Portland cement, was the commercially marketable mineral product was filed on March 9, 1955, and after six months the present action was brought by the taxpayer claiming a refund in the amount of \$166,811.04. By amended and supplemental complaints, the taxpayer alleged that the cost of bags and bagging the cement should be excluded from the computation (which, in relation to the net income limitation, increased the depletion of deduction) and prayed for judgment in the increased amount \$264,435.41, plus interest. [R. 64-65, 3-13, 43-45, 47-49.]

The District Court found that limestone of a relatively high calcium carbonate content is known in industry and commerce as chemical or metallurgical grade limestone. The actual computed high and low chemical analysis made approximately each week of the material mined by the taxpayer revealed a high of 87.68 per cent calcium car-

bonate and a low of 82.45 per cent, or an average of 85.20 per cent of calcium carbonate. The District Court held that this calcium carbonate content was not high enough to qualify the material as "chemical grade limestone" within the meaning of Section 114(b)(4)(A) of the Internal Revenue Code of 1939. [R. 64.]

It was further found that the taxpayer's commercially marketable mineral product from the mining of calcium carbonate was bulk Portland cement. In computing the gross income from the sale of Portland cement, total sales were reduced by the additional charge made by the taxpayer on its sales of Portland cement in bags, and by royalties, trade discounts, contract and own fleet trucking, rail freight, warehouse and bulk storage plant costs at distribution points away from taxpayer's cement plant. In computing net income from mining, the cost of bags and bagging and the other items enumerated above were excluded. The computation thus made resulted in gross income from mining of \$6,663,622.38 and net income from mining of \$1,257,641.79, with an allowable depletion deduction of \$628,820.89.² Accordingly, judgment in the amount prayed for in the complaint, \$264,435.41 plus interest, was entered. [R. 65-67, 72-73.]

The District Court refused to exclude from the gross and net income from mining calcium carbonate the income attributable to the raw materials clay #1, clay #2 (silica), gypsum, fluorspar, iron cinders and tufa. Under the computation included in the Government's proposed amendments to the proposed findings of fact and conclusions of

²The depletion allowable under Section 114 of Internal Revenue Code of 1939 is 10 per cent of the gross income from mining (\$666,362.24) but not to exceed 50 per cent of the net income from mining (\$628,820.89). Accordingly, the latter figure was used in the District Court's computation.

law, the exclusion of these items would have reduced the allowable depletion to \$521,462.18, and the refund to \$209,950.86. [R. 54-61.]

Statement of Points to be Urged.

In computing the taxpayer's percentage depletion base under Section 114(b)(4) of the Internal Revenue Code of 1939, consisting of the taxpayer's gross income from the mining of calcium carbonate, the District Court erred in failing to exclude income attributable to the additives clay #1, clay #2, fluorspar, gypsum, tufa and iron cinders.³

Summary of Argument.

I.

The Government's appeal involves the question whether the addition of raw materials in the manufacture of Portland cement is an ordinary treatment process applied to the taxpayer's limestone, which was held by the District Court to come within the statutory classification of "calcium carbonates." Under Section 114(b)(4) of the Internal Revenue Code of 1939 a depletion deduction for calcium carbonate is allowed in the amount of ten per cent of the taxpayer's gross income from mining calcium car-

³In the statement of points on which it intended to rely on cross-appeal [R. 148-149], the United States incorporated the designation of points on cross-appeal filed in the District Court. This designation included the additional point that the District Court erred in excluding the income attributable to bags and bagging from the computation of the depletion deduction. The decision on this point below accords in principle with the Government's position in other cases (*United States v. Utco Products*, 257 F. 2d 65 (C. A. 10th); *Commissioner v. American Gilsonite Co.*, 259 F. 2d 654 (C. A. 10th), cert. den. March 2, 1959), and was designated as error in this case for protective purposes only (see *Riverside Cement Co. v. United States* (S. D. Cal.), decided September 30, 1958 (58-2 U. S. T. C., par. 9905)). Accordingly, this point is abandoned.

bonate. Mining is defined as including the ordinary treatment processes customarily applied by mine owners and operators to obtain the commercially marketable mineral product. The District Court found that Portland cement is the commercially marketable product for the taxpayer's limestone (a calcium carbonate) and held that the income attributable to other raw materials, some mined by the taxpayer and some purchased, which the taxpayer added to the limestone in making Portland cement are includible in the taxpayer's depletion base.

We contend that "ordinary treatment processes" within the term "mining" means processes applied to the mined mineral. The blending of other raw materials with the calcium carbonate involved here is not a "treatment" of the calcium carbonate, but is the blending of additional raw materials in order to obtain the physical or chemical composition of the product Portland cement.

With respect to the ingredients which the taxpayer mined, *i. e.*, clay #1, clay #2 (silica), tufa and gypsum, it is clear that the statutory scheme prevents these minerals from being depleted as calcium carbonate. These minerals were either depletable at different rates or not entitled to percentage depletion at all. Here, the District Court's decision has the anomalous result of depleting them all at the ten per cent rate allowed for calcium carbonate, and on the erroneous premise that they are ordinary treatment processes.

Similarly, the purchased additives, fluorspar and iron cinders, should be excluded from the depletion base. Presumably the fluorspar and iron have been depleted by those who mined them. If the taxpayer purchased all the ingredients it would get no depletion allowance. The result as to purchased minerals should not be different where it mines some and purchases others.

II.

There is no merit in the taxpayer's contention that the District Court erred in classifying its mineral as calcium carbonate, depletable at a ten per cent rate, rather than as chemical grade limestone, depletable at a fifteen per cent rate. The record in this case and the opinions in other cases demonstrate that limestone suitable for use in the manufacture of Portland cement is a calcium carbonate rock within the meaning of the statute. The testimony and documentary evidence unequivocally shows that the mineral mined by the taxpayer is unsuitable for chemical uses. This is true because of the low calcium carbonate content and the relatively high level of impurities.

It should also be noted that unless some adjustment is made to the District Court's computation, such as is urged by the Government under point I, the question of the classification of the taxpayer's mineral will have no effect on the amount of the refund and will, of course, be moot. This is due to the fact that the amount of percentage depletion is limited to fifty per cent of the net income from mining, which limitation has been exceeded even at the ten per cent rate for calcium carbonate.

ARGUMENT.

I.

In Computing the Taxpayer's Percentage Depletion Base Under Section 114(b)(4) of the Internal Revenue Code of 1939, Consisting of the Taxpayer's Gross Income From the Mining of Limestone, the District Court Erred in Failing to Exclude Income Attributable to the Additives Clay #1, Clay #2, Fluorspar, Gypsum, Tufa and Iron Cinders.

Section 23(m) of the Internal Revenue Code of 1939, Appendix, *infra*, provides that in computing net income there shall be deducted a "reasonable allowance" for the depletion of natural deposits. Section 114(b)(4) Appendix, *infra*, provides for the computation of this allowance by the percentage depletion method and states so far as pertinent here, that—

The allowance for depletion under section 23(m) in the case of * * * mines and other natural deposits shall be—

*	*	*	*	*	*	*	*
(ii) in the case of * * * calcium carbonates,							
and magnesium carbonates, 10 per centum,							
*	*	*	*	*	*	*	*
of the gross income from the property * * *.							
*	*	*	*	*	*	*	*

This section also states that the allowance shall not exceed 50 per cent of net income from the property (computed without allowance for depletion). Section 114(b)(4)(B) then defines "gross income from the property" as meaning the "gross income from mining," which is in turn defined as including—

not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes

normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, * * *

Thus, in making the depletion computation for a given mineral it is necessary to determine first “the commercially marketable mineral product” and then “the ordinary treatment processes” which are used to obtain that product, excluding any step, such as bagging, which does not qualify as an ordinary treatment process.

In this case the District Court found that the commercially marketable mineral product of the taxpayer's limestone (held to fall within the statutory classification of “calcium carbonates,” see Argument, *infra*) was bulk Portland cement.⁴ [R. 65.] In computing the taxpayer's “gross income from mining” the limestone, the court disallowed as ordinary treatment processes the cost of bags and bagging, royalties, trade discounts, transportation costs, and warehouse and bulk storage plant costs at distribution points. [R. 66-67.] However, the District Court refused to approve the Government's position that income attributable to certain mined and purchased raw materials which were added to the limestone to make cement—clay #1, clay #2, fluorspar, gypsum, tufa and iron cinders—should also be excluded from the computation. [R. 54-60, 61.]

We concede that the act of blending raw materials is an ordinary treatment process in making Portland cement; that is, that the cost of labor, electricity, etc., used to physically mix the limestone with other raw materials may be included in the depletion base. However, we

⁴The question whether the taxpayer's first commercially marketable mineral product was Portland cement or some lesser product is no longer in issue.

strongly urge that the income attributable to the added materials themselves⁵ should *not* be included in the depletion base.

To begin with, the depletion allowance is designed simply as taxfree compensation to the taxpayer for the part of its limestone deposit which it used up in production. See *Kirby Petroleum Co. v. Commissioner*, 326 U. S. 599; *Commissioner v. Southwest Expl. Co.*, 350 U. S. 308, 312; *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503. In the computation approved by the District Court the taxpayer is not only allowed an offset for the depletion of the limestone deposit but is also allowed to deplete its other mined products (clay, gypsum and tufa) at the same rate, and in addition is allowed to deplete things which it does not even mine (fluorspar and iron cinders).

This unsound result is reached by characterizing the addition of these raw materials as an ordinary treatment process applied to the mined limestone. But the statutory phrase "ordinary treatment processes" has been interpreted, and correctly we submit, as being limited to processes applied to the mined mineral itself. Thus in *United States v. Utco Products*, 257 F. 2d 65, 68 (C. A. 10th), the court, in considering whether bags and bagging were includible in the depletion base, stated:

We are of the opinion that the phrase "ordinary treatment process," except where the statute otherwise provides, means a process of treating which separates the mineral from other minerals in which it is found or with which it is associated, or which effects a chemical or physical change *in the mineral*

⁵Or, alternatively, the cost or fair market value of the raw material additives.

itself, such as crushing, separating, removing impurities, pulverizing, hardening and the like. (*Italics supplied.*)

See also *Commissioner v. American Gilsonite Co.*, 259 F. 2d 654 (C. A. 10th), certiorari denied March 2, 1959. This language is a clear expression of the Government's premise that ordinary treatment processes, within the statutory meaning, includes only those steps which are in fact a *treatment* of the *mineral* being depleted.

The statute itself reinforces this position by stating in Section 114(b)(4)(B):

The term "ordinary treatment processes," as used herein, shall include the following: (i) in the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extracting of the product or products from ore, including the furnacing of quicksilver ores.

It is noteworthy that, in all the examples of ordinary treatment processes listed in the statute, the allowed processes are treatments applied directly to the ore or mineral. Nowhere does the statute indicate that the addition of another raw material will be viewed as an ordinary treatment process.

The District Court has apparently failed to appreciate the difference between a process and an ingredient. Just as a baker does not “treat” flour with milk, sugar, eggs and shortening to obtain the bakery product cake, so here the manufacturer of Portland cement does not “treat” limestone with clay, silica (clay #2), fluorspar, tufa, iron cinders and gypsum. In both cases the product is achieved by blending ingredients, instead of treating one raw material with another.

That the mined and purchased materials involved here are in fact raw materials or ingredients clearly appears in the record. After the limestone has been crushed and ground it is transported to the cement plant where it is placed in a hopper. Then [R. 22]—

The limestone [calcium carbonate] from its hopper is then blended with clay #1 from another hopper, with clay #2 from another hopper and with iron cinders from another hopper by measuring and conveying equipment.

After this “physical proportioning of the raw materials” [R. 18], the combination is mixed with water and further ground into a slurry which is fed into the kiln to emerge as a cement clinker. The clinker is then ground with gypsum to become one of the various types of Portland cement. [R. 21-24.] Thus, while it may be agreed that the act of blending is an ordinary treatment process, surely the position that the cost of these raw materials

should be included in the depletion base for calcium carbonate is indefensible.

A bulletin published by the Bureau of Mines (Bulletin 556, Mineral Facts and Problems, Bureau of Mines, 1956) demonstrates the reason for adding materials such as those used by the taxpayer. It states (p. 161):

A large number of raw materials theoretically is available for making portland cement, but the number has been reduced to a comparative few under existing commercial conditions. Argillaceous limestone, or "cement rock," of very close to the required lime-silica-alumina-iron oxides proportions sometimes is combined with minor quantities of other materials to produce the proper mixture. More often the necessary lime is supplied by one material (limestone, oystershells, or marl), the silica by sand or sandstone (or as a component in clays and shales), the alumina by clays and shales, and the iron oxide by iron-bearing materials or by high-iron clays and shales.

The four broad "type combinations" of portland cement raw materials, as classified in Minerals Yearbook, are (1) cement rock-pure limestone, (2) limestone clay (or shale), (3) marl-clay, and (4) blast-furnace slag-limestone.

* * * * *

Besides the major materials, the following minerals and other substances, some of which are used only very rarely, are among those added to help obtain a raw mixture of correct chemical and physical characteristics: Bentonite, diaspore, diatomaceous shale, fuller's earth, iron ore, mill scale, pyrite cinders and ore, diatomite, fluorspar, pumicite, flue dust, pitch, red mud and rock, hydrated lime, tufa, cinders, and calcium chloride.

See also Ex. 14, R. 119-120; Ex. 23, R. 129.

It is abundantly clear that the raw materials mined by the taxpayer and added to the limestone to make cement—Clay #1, clay #2 (silica), tufa, and gypsum—should not be included in the computation so as to be depleted as calcium carbonate. Here we have a taxpayer which mines five different types of natural deposits and is seeking to deplete them all as one type of deposit, and at the one percentage rate provided therefor, simply because they were all used in making cement. If the mined additives (the clay, tufa, and gypsum) are depletable at all, they are depletable at whatever percentage rates are provided as to each, not as calcium carbonate. And a second depletion deduction cannot be allowed on the ground that the addition of these raw materials to limestone is a treatment process in making cement.

As to the purchased ingredients, iron cinders and fluor-spar, the case is equally clear. This taxpayer does not mine iron ore or fluorspar. These materials have been mined by other taxpayers who presumably have claimed the statutory depletion allowance and cannot be depleted by a taxpayer who had no economic interest in their production. *Commissioner v. Southwest Expl. Co.*, 350 U. S. 308. Following this same theory, if a producer of Portland cement purchased all of the necessary ingredients he would not be entitled to any depletion allowance since he neither mines nor has a capital investment in the minerals. Can a different result with respect to purchased ingredients be justified when a producer mines some raw materials and purchases others?

The taxpayer on brief (p. 55) discounts “any superficial logic” of these arguments and suggests that it is neither absurd nor unusual to allow a double depletion allowance.⁶ In support of this view it points out that fuel oil and gas used for heat are derived from depletable resources yet are not excluded from the computation. However, the fuel oil and gas are typical examples of materials used in a process (here heating the kiln) as opposed to mineral components or ingredients used in physical or chemical proportioning. Thus, it is not the Government’s position that the cost of ordinary treatment processes should be excluded, but merely that the distinction between blending raw materials and processing or treating a mineral be reflected in the computation.

The taxpayer also cites (Br. 56-57) this Court’s decision in *New Idria Quicksilver Min. Co. v. Commissioner*, 144 F. 2d 918, as supporting a double depletion allowance for so-called additives. To begin with, it should be noted that this issue was neither raised nor ruled upon in that

⁶The taxpayer also maintains (Br. 49, *et seq.*) that the issue was covered by stipulation below which bars the appeal on this point. However, the stipulation provides [R. 21]—

that the *extraction and processing operations* set forth below for the mining of the calcium carbonate rock known as “limestone” are includable in determining gross income from mining * * *. (Emphasis supplied.)

There is no provision in the stipulation that the cost of additional materials or the income attributable to them should be included in the computation. Indeed, this issue was discussed in the Supplemental pretrial Memorandum for the Defendants, p. 27 [R. 142], and was discussed at length at the trial [R. 82-90, 92-94]. At one point the taxpayer expressed a willingness to concede the issue as to the purchase additives. [R. 111.] Finally, the Government introduced a proposed computation excluding these items which the District Court refused to adopt. [R. 54-60, 61.]

case. Moreover, that case involved the extraction of quicksilver from cinnabar ore and did not even implicitly rule on the blending of additional raw materials as an ordinary treatment process. There, slack lime was added to condensed quicksilver (p. 919) "to cleanse it and also to free the quicksilver."

Similarly, although the issue may have been present in other appellate decisions (see *e.g.*, *Dragon Cement Co. v. United States*, 244 F. 2d 513 (C. A. 1st), certiorari denied, 355 U. S. 833), it was not litigated or specifically considered. The lower courts have reached varying results. In *Riverside Cement Co. v. United States* (S. D. Calif.), decided September 30, 1958 (58-2 U. S. T. C. par. 9905), appeal pending (C. A. 9th), the same District Court held, pursuant to a concession, that the additive quartzite should be excluded from the depletion computation, but that other additives were includible.

In the *Sparta Ceramic Co. v. United States* (N. D. Ohio), decided November 12, 1958 (58-2 U. S. T. C. par. 9965), appeal pending (C. A. 6th), although certain additives were included as ordinary treatment processes, the court excluded the costs of glazing tile and remarked "Adopting the taxpayer's viewpoint, it could gold plate or stud the tile with diamonds. It is not believed that these additives could be considered in arriving at a proper depletion base." See also, *California Portland Cement Co. v. Riddell* (S. D. Calif.), decided November 21, 1958 (59-1 U. S. T. C. par. 9156), appeal pending (C. A. 9th).

In *Riverton Lime & Stone Co. v. Commissioner*, 28 T. C. 453, the Tax Court held that a producer of hydrated hydraulic lime correctly computed its depletion allowance by using the price received for sale of the pure product rather than the price received for sales which

included additives. See also *Black Mountain Corp. v. Commissioner*, 21 T. C. 746; *Iowa Limestone Co. v. Commissioner*, 28 T. C. 881, 883. In the latter case it was stated that "The blending of chemicals would not constitute ordinary treatment processes."

As is readily apparent from these decisions, the issue has received varying treatment in the lower courts and this case is one of first appellate impression.

It is submitted that a proper construction of the statutory language prevents the cost of or the income attributable to raw material additives from being included in the depletion base for calcium carbonate. Each mineral entitled to a depletion allowance must meet the statutory tests on its own and not, as here, be allowed some sort of vicarious depletion allowance by mislabeling it a treatment process. This result, it is submitted, is not only legally sound but is also dictated by logic and reason. As this Court stated in *Brea Canon Oil Co. v. Commissioner*, 77 F. 2d 67, 69:

While the act of Congress and regulations adopted in pursuance thereof must be construed according to their plain import, it should be borne in mind in determining the amount of the depletion allowance that such allowance is intended to represent the amount of capital recovered in the product produced by the well [mine], that is the value of raw product.

Such a principal precludes the inclusion of raw material additives in the computation of the depletion allowance for calcium carbonate.

II.

The District Court Correctly Held That the Mineral Mined by the Taxpayer Was Calcium Carbonate Rather Than Chemical Grade Limestone.

As detailed earlier, the statute (Sec. 114(b)(4) of the Int. Rev. Code of 1939) provides for depletion allowances for specified minerals in stated percentages of the gross income from mining the mineral, but subject to the limitation that in no event shall the allowance exceed 50 per cent of the *net* income from mining. The taxpayer here asserts that the District Court erred in classifying its limestone as calcium carbonate (10 per cent), rather than as chemical grade limestone (15 per cent). It should be noted at the outset that, as the District Court's computation now stands [R. 66-67], the net income limitation is in effect and the question of whether the taxpayer is entitled to the 10 per cent rate or the 15 per cent rate is moot. However, since the taxpayer feels it is aggrieved in other ways by this holding and since the issue may again become important if the Government's position in Point I is accepted,⁷ the taxpayer's contention that the District Court erred in this respect will be dealt with herein.

The District Court found [R. 63] that the taxpayer "mined a calcium carbonate rock known generally as

⁷Under the computation approved by the District Court [R. 66-67] the 10 per cent allowance for calcium carbonate is \$666,362.24, but 50 per cent of the net income from mining is \$628,820.89. Thus, the maximum depletion allowance, whether the applicable rate is 10 or 15 per cent, is the same, namely, \$628,820.89. However, if the Government is right on the question of additives, *supra*, and its proposed computation [R. 56-60] is accepted, there will again be a dollar amount controlled by the depletion rate, since under that computation the net income limitation is higher than the 10 per cent rate for calcium carbonate.

‘limestone’ ” and further found [R. 64] that “The calcium carbonate content of plaintiff’s limestone involved in this case was not high enough to qualify the material as ‘chemical grade limestone’ * * *.”

There is ample support for the holding that the taxpayer’s mineral is calcium carbonate. Treasury Regulations 111, Section 29.23(m)-5, Appendix, *infra*, define calcium carbonate as—

Miscellaneous limestones and other calcium carbonate rocks (not specifically provided for at a 5 percent or 15 percent rate of percentage allowance) such as cement rock and limestone used or sold for use in soil treatment. This classification does not include rock or minerals used or sold for use as ballast, road making, concrete aggregates, or other purposes for which chemical composition is not a major requirement.⁸

Thus, taxpayer’s limestone is a “calcium carbonate” if, contrary to the taxpayer’s contention, it is not “chemical grade limestone” entitled to depletion at a 15 per cent rate. Cases involving limestones similar to taxpayer’s have consistently applied the 10 per cent rate provided for calcium carbonates. See *Dragon Cement Co. v. United States*, 144 F. Supp. 188, 189 (Me.), reversed on other grounds, 244 F. 2d 513 (C. A. 1st), certiorari denied, 355 U. S. 833; *California Portland Cement Co. v. Riddell*, *supra*; *Riverside Cement Co. v. United States*, *supra*.

As the District Court held, the taxpayer’s limestone was not chemical grade limestone. The court found [R. 70] that chemical grade limestone means “a limestone

⁸A recently proposed regulation would amend this definition by striking all after “cement rock” and substituting “and agricultural limestone.” 24 Fed. Register, No. 28, pp. 975, 976.

which is of a relatively high calcium carbonate content.” This definition is not only supported by the evidence of record in this case but also coincides with judicial and administrative meanings given the term. In *United States v. Wagner Quarries, Co.*, 260 F. 2d 907, 908 (C. A. 6th), the court stated:

Based upon a fair appraisal of the testimony of the experts, a reasonable interpretation of congressional intent in using the words “metallurgical grade limestone, chemical grade limestone,” would mean a limestone of high carbonate content with a very low silica or impurities percentage, capable of use for metallurgical or chemical purposes.

In *Iowa Limestone Co. v. Commissioner*, 28 T. C., p. 884, it was stated:

The record shows that limestone which is at least 95 per cent pure, free from toxic impurities, and containing not more than 1 per cent moisture, is known in industry and commerce as chemical grade limestone.

While the applicable Treasury Regulations (Reg. 111, Sec. 29.23(m)-5) define chemical grade limestone merely as “Limestone used or sold for use in the chemical trades,” this use test has been abandoned after rejection by the courts (*e.g.*, *Virginian Limestone Corp. v. Commissioner*, 26 T. C. 553) and newly proposed Regulations conform to the above definitions.⁹

It is apparent from the chemical analysis of the taxpayer’s calcium carbonate that it does not qualify under

⁹“Limestone, chemical and metallurgical grade. Limestone containing a calcium carbonate and magnesium carbonate content totaling 95 percent or higher by weight provided that such magnesium carbonate content is less than 35 percent by weight.” Proposed Treasury Regulations, 24 Fed. Register, No. 28, pp. 975, 976.

any of these definitions of chemical grade limestone. The average calcium carbonate content of the taxpayer's mineral is 85.20 per cent [R. 64], well below the requirements of 95 per cent. Nor, does this percentage qualify as "relatively high" or "high" calcium. [R. 70.] The record shows that "Limestone containing more than 95 per cent Ca CO_3 is commonly referred to as high-calcium limestone." [Ex. 15, R. 120-121.]

In addition, the impurities contained in limestone are of crucial importance in determining whether a limestone is of chemical grade. See the specifications for various chemical uses of limestone reproduced in Stipulation No. 1. [R. 34-38.] The relatively high level of impurities in the taxpayer's mineral (particularly silica (Si O_2) and alumina (Al_2O_3)) [R. 21] make it unsuitable for many chemical uses such as the manufacture of glass, calcium carbide, alkalies and paper. [R. 34-38.]

The taxpayer takes exception to the District Court's definition and would define chemical grade limestone as "limestone suitable for use in any industrial chemical application." (Br. 16.) Therefore, the argument runs, since the production of Portland cement involves complex chemical reactions, limestone suitable for use in the manufacture of Portland cement is chemical grade limestone.

The fallacy of this argument is that it ignores the accepted meaning of the term "chemical grade limestone," which refers to a relatively pure limestone of high carbonate content. There is nothing in the record to suggest that any limestone which is capable of being used in a chemical reaction is automatically chemical grade. Moreover, even if Portland cement manufacture were conceded to be a chemical industry (which it is not) the test is not how a particular mineral is actually used, but is whether

it qualifies under commonly understood commercial meanings. See *e.g.*, *Virginian Limestone Corp. v. Commissioner*, *supra*, where the mineral was held to be depletable as dolomite (10 per cent) even though some of it was sold for use as metallurgical limestone (15 per cent).

That the industry is well acquainted with chemical grade limestone as a term which is used to describe limestones useable for such chemical purposes as alkali manufacture, calcium carbide manufacture and in the glass, paper and sugar industries clearly appears from the deposition of a qualified expert, Dr. Bowles. [R. 124-126.]

The taxpayer's reliance (Br. 29-31) on Rev. Rul. 56-582, 1956-2 Cum. Bull. 981, to prove syllogistically that it mines a chemical grade limestone is equally misplaced. Initially, it should be noted that the ruling refers to the production of lime by the calcination of calcium carbonate (CaCO_3), and the record here is clear that the taxpayer's deposit could not be used in the production of lime. [Ex. 23, R. 127.]¹⁰ Moreover, the end use method of classifying limestone as set forth in this ruling was specifically rejected in *Wagner Quarries Co. v. United States*, 154 F. Supp. 655 (N. D. Ohio), affirmed, 260 F. 2d 907 (C. A. 6th), and is no longer being urged by the Government.

In summary, the allowance of a depletion deduction is a matter of legislative grace (*Commisisoner v. Southwest*

¹⁰Dr. Oliver Bowles deposed as follows [R. 127]:

Q. Would you consider a limestone used for lime manufacture as a chemical limestone?

A. Yes. I would.

Q. Why would you do so, when you rule out limestone for cement manufacture?

A. Because limestone used for lime manufacture is generally, or almost invariably, a very high grade. A large part of the lime manufactured in the United States is made from stone running more than 98 per cent calcium carbonate.

Expl. Co., 350 U. S. 308) and the burden was upon the taxpayer to prove entitlement to the allowance for chemical grade limestone. There is in this case ample judicial precedent and record support for the District Court's holding that the taxpayer mined calcium carbonate rather than chemical grade limestone.

Conclusion.

For the reasons stated above, the case should be remanded to the District Court to exclude from the depletion base for calcium carbonate the income attributable to other mined and purchased raw materials. In all other respects the decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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APPENDIX.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(m) *Depletion*.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

For percentage depletion allowable under this subsection, see section 114(b), (3) and (4).

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * *

(4) [as amended by Sec. 145(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798; Sec. 124 of the Revenue Act of 1943, c. 63, 58 Stat. 21; and Sec. 319(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In general.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum.

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance from section 23(m) be less than it would be if computed without reference to this paragraph.

(B) [as amended by Sec. 304(d), Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137; and Section 207(a), Revenue Act of 1950, c. 994, 64 Stat. 906] *Definition of gross income from property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals

from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes," as used herein, shall include the following: (i) in the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles

of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(m)-1. *Depletion of Mines, Oil and Gas Wells, Other Natural Deposits, and Timber: Depreciation of Improvements.*—Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

* * *

When used in these sections (23.23(m)-1 to 23.23(m)-28, inclusive) covering depletion and depreciation—

* * *

(d) [As amended by T.D. 5413, 1944 Cum. Bull. 124] “Minerals” include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barite, beryl, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller’s earth, graphite, gravel, gypsum, lepidolite, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, spudomene, sulphur, talc and vermiculite.

* * *

(f) [As amended by T.D. 5413, *supra*; T.D. 5458, 1945 Cum. Bull. 45; T.D. 5461, 1945 Cum. Bull. 284; T. D. 6004, 1953-1 Cum. Bull. 45; T.D. 6031, 1953-2 Cum. Bull. 120] The term “gross income from

the property,” as used in sections 114(b)(3) and 114(b)(4)(A) and sections 29.23(m)-1 to 29.23(m)-19, inclusive, means the following:

In the case of oil and gas wells, “gross income from the property” as used in section 114(b)(3) means the amount for which the taxpayer sells the oil and gas in the immediate vicinity of the well. If the oil and gas are not sold on the property but are manufactured or converted into a refined product prior to sale, or are transported from the property prior to sale, the gross income from the property shall be assumed to be equivalent to the representative market or field price (as of the date of sale) of the oil and gas before conversion or transportation.

In the case of a crude mineral product other than oil and gas, “gross income from the property,” as used in section 114(b)(4)(A), means the gross income from mining. The term “mining” as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products. * * *

If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, “gross income from the property” means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, “gross income from the property” means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as benefited by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or

field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method. For a description of transportation which is treated, for taxable years beginning after December 31, 1949, as mining, see the preceding paragraph and section 114(b)-(4)(B), as amended.

The term "ordinary treatment processes," as used herein, shall include the following:

(1) In the case of coal—cleaning, breaking, sizing and loading for shipment;

(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;

(3) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(4) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and

beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic) cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the term "ordinary treatment processes." The following processes are not included in the term "ordinary treatment processes"; electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

In addition, the processes listed below are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in (1), (2), (3), or (4) above; (ii) necessary or incidental to the processes provided for in (1), (2), (3), or (4) above; or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates):

- (A) treatment effecting a chemical change,
- (B) blending with other material,
- (C) thermal action,
- (D) fine pulverization, pressing into shape, or molding.

For the purposes of (3) and (4) above, the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

* * *

(h) "Crude mineral product," as used in paragraph (f) of this section, means the product in the form in which it emerges from the mine or well.

* * *

SEC. 29.23(m)-5 [As amended by T.D. 6031, *supra*]. *Computation of Depletion Based on Percentage of Income in Case of Certain Mines or Other Natural Deposits.*— * * *

* * *

For the purposes of this section, the minerals indicated below shall have the following meanings:

* * *

Calcium carbonates.....	Miscellaneous limestone and other calcium carbonate rocks (not specifically provided for at a 5 percent or 15 percent rate of percentage allowance) such as cement rock and limestone used or sold for use in soil treatment. This classification does not include rock or minerals used or sold for use as ballast, road making, concrete aggregates, or other purposes for which chemical composition is not a major requirement.
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* * *

Limestone, chemical grade.....	Limestone used or sold for use in the chemical trades.
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Limestone, metallurgical grade..	Limestone used or sold for use in the production of metals.
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* * *

Stone.....All common dimension, crushed or broken stone within the ordinary meaning of these terms.

* * *